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External debt sustainability and development

Report of the Secretary-General

Summary

The present report, submitted pursuant to General Assembly resolution 67/198, reviews recent developments in the external debt of developing countries, with a special focus on the policy considerations faced by developing countries in maintaining debt sustainability in the current macroeconomic environment.

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I. Introduction

1. The present report is submitted in accordance with paragraph 37 of General Assembly resolution 67/198. It includes a comprehensive analysis of the external debt situation and debt servicing problems faced by developing countries and economies in transition[1] (henceforth referred to as developing countries). It describes new developments and trends in external debt and related areas of development finance, discusses various issues relating to the debt situation of least developed countries and their financing options, as well as policy considerations for maintaining debt sustainability in the current macroeconomic environment, and provides a basis for deliberation of related policy issues to reduce the prevalence and cost of debt crises.

II. Recent trends

2. Total external debt stocks of developing countries are estimated to have reached $4.8 trillion in 2011, marking a 10.7 per cent increase over 2010 figures (see annex). Estimates made by the United Nations Conference on Trade and Development (UNCTAD) secretariat indicate that debt levels continued to grow by approximately 12.4 per cent over 2011-2012, bringing the total external debt of developing countries to an estimated $5.4 trillion in 2012. This marks the third consecutive year that the growth of external debt of developing countries has exceeded 10 per cent, following nearly a decade of average growth of around 7 per cent. Long-term debt represents 70 per cent of total debt stocks and is mainly owed to private creditors. The share of official long-term lending to developing countries continued to decline in 2011 and 2012. At the same time, the share of short-term debt increased to $1.2 trillion in 2011 and to an estimated $1.4 trillion in 2012, constituting more than a quarter of total debt stocks.

3. Average gross domestic product (GDP) in real terms for the group grew by 6.1 per cent in 2011 and is estimated to have grown at a more modest pace in 2012, by 4.7 per cent. Similarly, exports continued to grow by 7.2 per cent in 2011, but preliminary figures suggest that export growth slowed to 3.3 per cent in 2012. As a result, debt ratios for the group as a whole are estimated to have worsened in 2012 after a slight improvement in 2011. From 2011 to 2012 total debt to GDP increased from 20.7 per cent to 22 per cent, debt service to exports rose from 7.9 per cent to 8.5 per cent, and total debt to exports increased from 68.3 per cent to 75.2 per cent.

4. International reserves for all developing countries increased to $6.2 trillion in 2012 from nearly $6 trillion in 2011, although their rate of growth declined to 5 per cent in 2012, marking the lowest rate in more than a decade. The average ratio of international reserves to GDP for the period 2008-2009 was 26.6 per cent, up from 21.3 per cent for the 2003-2007 period. The stock of international reserves continues to outweigh the stock of total debt for developing countries when taken as a group, although the faster growth of debt than of reserves since 2008 is a matter of concern.

5. The share of Eastern European and Central Asian debt as a percentage of the total external debt of developing countries stands at an estimated 28.4 per cent, the highest of all regions. The region's debt-to-GDP ratio, already the highest of all the regions in 2011, rose further from 39.3 to 41.1 per cent in 2012, mainly as a result

[1] As defined by the World Bank International Debt Statistics 2013 online database.

of an increase in short-term debt. However, the overall debt position is supported by large holdings of international reserves and a healthy reserve-to-short-term-debt ratio in excess of 200 per cent. Furthermore, the cost of borrowing for the region has come down and is now well below the peak reached in 2009. The main issue for the region remains the relatively slow recovery in export and GDP growth due to continued slow growth in Western Europe.

6. Total debt stocks in sub-Saharan Africa reached $313.2 billion in 2012 as external debt continued to grow by 6.4 per cent, though at a slower pace than the 9 per cent growth in 2010 and 2011. The region's share of total debt stocks of developing countries continued to decline in 2012 to an estimated 5.8 per cent. The majority of the region's total debt is long-term debt (accounting for 79.3 per cent), of which less than half is owed to official creditors. The region's debt ratios have improved markedly since 2000 owing in large part to debt relief delivered under the Heavily Indebted Poor Countries (HIPC) and the Multilateral Debt Relief Initiatives and continued economic growth. Total debt to GDP was 24.3 per cent in 2012, compared with 62.5 per cent in 2000, the total-debt-to-exports ratio was 66.1 per cent, down from 182.6 per cent in 2000, and the debt-service-to-exports ratio was 3.5 per cent in 2012, versus 10.5 per cent in 2000. In addition, international reserves have steadily increased to $200.1 billion in 2012, more than five times the level in 2000. Eight countries have issued sovereign bonds on international capital markets since 2009, owing in part to improved debt indicators.[2] This trend has been fuelled by low interest rates in advanced economies combined with investors seeking risk-adjusted returns and diversification opportunities. New issuances bring both opportunities and risks that countries will need to manage.

7. In Latin America and the Caribbean, total debt stocks were $1.2 trillion in 2011 and are estimated to have reached $1.4 trillion in 2012. The region has experienced an average GDP growth rate of at least 4 per cent since 2003, which occurred in combination with current account surpluses and sizeable real exchange rate appreciation. In addition, most countries underwent improvements in external financing conditions as sovereign yield spreads narrowed. These factors contributed to a dramatic improvement in the region's debt ratios between 2003 and 2008.[3] The debt ratios experienced a temporary up-tick in 2009, following the outbreak of the financial crisis, but subsequently subsided and have since remained steady, except for the debt-to-GDP ratio. The debt-service-to-exports ratio remained about 13 per cent in 2011 and 2012 and debt service to GDP rose slightly from 2.9 per cent in 2011 to an estimated 3.1 in 2012, although total debt to GDP increased from 22.1 per cent to an estimated 25 per cent in 2012. The region's total debt stocks are largely long-term and are owed primarily to private creditors, with less than 20 per cent owed to official creditors. The region also experienced a sizeable increase in foreign assets, with international reserves increasing to an estimated $784.8 billion in 2012; reserves grew at the more modest pace of 8.2 per cent in 2012, compared with growth rates varying between 10 and 45 per cent since 2003. GDP growth in the region has been gradually slowing over the past three years, which is attributed to a weaker global economy and lower domestic demand.

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[2] International Monetary Fund (IMF), *Regional Economic Outlook: Sub-Saharan Africa — Building Momentum in a Multi-Speed World*, World Economic and Financial Surveys (Washington, D.C., May 2013).

[3] IMF, *Regional Economic Outlook: Western Hemisphere — Time to Rebuild Policy Space*, World Economic and Financial Surveys (Washington, D.C., May 2013).

8. Total debt stocks in the Middle East and North Africa are estimated to have increased in 2012 by 3 per cent, to $171.1 billion, after registering nearly no growth in 2011 and 3 per cent growth in 2010. The region continues to hold the smallest share of the total external debt of developing countries, amounting to 3.2 per cent. This share has continually declined since 2000, when it was 6.8 per cent. Long-term debt accounts for 72 per cent of the region's total debt, of which more than 60 per cent is owed to official lenders. Total debt to GDP and debt service to GDP remained steady compared with 2011, while debt service to exports increased 1 per cent year on year. The region continues to face political and economic challenges associated with the Arab Spring, which broke out in 2010. Countries in transition incurred higher fiscal deficits and public debts as a result of crisis management that diminished policy buffers. International reserves contracted in 2011 by 1.1 per cent and in 2012 by 4.1 per cent, to $355 billion, following a decade of continued growth ranging between 19 and 32 per cent.

9. In East Asia and the Pacific, total debt stocks continued to grow at a high rate of 18.8 per cent to reach $1.4 trillion in 2012. The up-tick in the growth rate of total debt began in 2009, while total-debt-to-GDP ratios have remained relatively steady at 14 per cent during this period as the region has benefited from robust economic growth. Slightly less than half of the region's debt stocks are composed of long-term debt, of which only 35 per cent is owed to official creditors. International reserves reached $3.8 trillion in 2012. These averages mask large differences among countries. In particular, China accounts for 57 per cent of the total debt stock but has the lowest ratios in the region. When China is excluded from the regional average, the growth rate of total debt stocks is lower at 14 per cent in 2012, following a 9 per cent increase in 2011. In contrast, the majority of the region's total debt stocks (75 per cent) when excluding China is long-term. The debt ratios for the region excluding China are estimated to be higher, with debt service to exports at 7.9 per cent, total debt to GDP at 31.3 per cent and total debt to exports at 64 per cent in 2012. These ratios deteriorated slightly from 2011 to 2012. International reserves excluding China amounted to $528 billion in 2012, an increase from $501 billion in 2011.

III. Debt situation of the least developed countries and their financing options

10. In 2012, the total external debt of the 49 countries classified as least developed countries increased to an estimated $183 billion, up 6.7 per cent in nominal terms compared to 2011. As a result, the ratio of debt to GDP increased from 26.3 per cent in 2011 to 26.7 per cent in 2012 and the ratio of total debt to exports increased from 78.7 to 82.5 per cent. Both debt ratios were higher than the respective ratios of developing countries.[4]

11. Since the majority of external debt for least developed countries is long-term (81.2 per cent) on highly concessional terms, the average debt service as a percentage of GDP and exports remained lower compared with other groups, at 1.5 per cent and 4.7 per cent, respectively, in 2012. Meanwhile, the total stock of short-term debt increased by $2.5 billion, or nearly 14 per cent, in 2012. The total

[4] UNCTAD calculation based on the International Debt Statistics 2013 online database.

amount of foreign reserves covered nearly five times the amount of short-term debt, which is similar to the ratio of the developing countries and sub-Saharan Africa.

12. As at April 2013,[5] there were 2 least developed countries in debt distress (Myanmar and Sudan) and 10 in high risk of debt distress (Afghanistan, Burundi, Comoros, Democratic Republic of the Congo, Djibouti, Gambia, Haiti, Kiribati, Sao Tome and Principe and Yemen). Both the Comoros and Guinea reached the completion point in 2012 under the HIPC Initiative and, as a result of the debt cancellation obtained from the Paris Club, are no longer considered to be in debt distress.

13. A combination of strong growth, prudent macroeconomic management and debt relief has produced a sharp decline in debt burdens for many least developed countries in sub-Saharan Africa. However, the public debt ratios have been rising in many post-HIPC/Multilateral Debt Relief Initiatives countries in recent years. The increase in debt-to-GDP ratios following the Multilateral Debt Relief Initiative has been quite significant in several cases, including Benin, Ghana, Senegal and Malawi, where the surge in the debt ratio largely reflects sharp exchange rate depreciation in 2012, rather than new borrowing.[6] High levels of public debt are a constraint on fiscal policy space, since many countries could find it difficult to finance budget deficits in the event of an economic downturn.

14. Overall the growth performance of the least developed countries improved in 2012, with an average growth rate of 4.8 per cent compared with 3.7 per cent in 2011.[7] While some least developed countries experienced an acceleration of growth due mostly to a significant recovery in the oil sector (Angola) or new extractive operations (Sierra Leone), growth contracted notably in some other countries, including Guinea-Bissau, Mali, Solomon Islands and Uganda, owing to various reasons, such as internal conflict or tightening monetary policy. Furthermore, fiscal space has deteriorated for a number of least developed countries as a result of sluggish growth and higher fiscal deficits.

15. The average current account deficit of least developed countries as a percentage of GDP worsened from 1.7 per cent to 3 per cent in 2012.[8] Within the group, performance varied markedly as oil exporters typically recorded improved trade and current account positions, whereas non-oil mineral exporters tended to see their balances deteriorate. In 2012, the current account of 27 least developed countries worsened, reflecting in part the continued sluggish performance of exports in several cases and the strong rising import demand observed in some least developed countries, such as Burkina Faso, Guinea and Mozambique. In 2012, most least developed countries (43 out of 49 countries for which data are available) were still running large current account deficits. A total of 24 least developed countries had deficits greater than 8 per cent of GDP, which in some cases exceeded 20 per cent (Bhutan, Guinea, Liberia, Mauritania, Mozambique, Niger and Sao Tome and Principe).

16. Least developed countries and African countries, in particular, have huge infrastructure needs in key sectors, such as electricity generation and distribution,

[5] IMF list of low-income countries' debt sustainability analyses for Poverty Reduction and Growth Trust-eligible countries as at 4 April 2013. Available from www.imf.org/external/pubs/ft/dsa/dsalist.pdf.

[6] IMF, *Regional Economic Outlook: Sub-Saharan Africa*.

[7] UNCTAD, UNCTADstat.

[8] UNCTAD staff calculation based on IMF balance-of-payments data and UNCTADstat.

roads, airports and ports, and thus a large demand for new resources to be invested. Thus, the way investment projects are financed will have a significant impact on both the long-term growth of least developed countries and the sustainability of their debts.

17. Least developed countries have fewer opportunities and sources of financing compared with other developing countries. With some exceptions, domestic debt markets are not sufficiently developed, especially in the long-maturity segment, and the resources that can be raised are constrained by the limited amount of savings. Developing a domestic debt market is also costly in terms of financial and human resources. More importantly, domestic borrowing cannot fully replace external financing because least developed countries must raise foreign exchange to buy foreign capital goods and equipment for investment projects. Current account imbalances suggest that foreign capital will continue to play an important role in the development of least developed countries.

18. Foreign capital flows to least developed countries are mainly in the form of concessional loans from official donors or foreign direct investment (FDI). The high share of FDI in total capital flows to least developed countries is partly due to the very small amount of private loans and portfolio investments. In the case of least developed countries where the debt is deemed sustainable, little borrowing on commercial terms reflects the stringent limits that these countries have to abide by for non-concessional borrowing in order to continue to obtain access to highly concessional loans from Bretton Woods institutions. However, since 2009, the International Monetary Fund (IMF) limits on borrowing at non-concessional terms for countries under IMF-supported programmes have become more flexible, and exemptions have been granted on the basis of an assessment of a country's capacity[9] and the extent of its debt vulnerabilities.[10] For example, Senegal and, more recently, Rwanda and the United Republic of Tanzania have been exempt from concessionality requirements and can place bonds on international markets.

19. Greater access to private foreign capital could endow least developed countries with much-needed resources to overcome the large infrastructure deficit that hinders their long-term economic growth. As a result, the current policy framework, which restricts borrowing on commercial terms by countries under IMF- and World Bank-supported programmes, has come into question as it affects the majority of least developed countries. Indeed, countries under such programmes must satisfy strong concessionality requirements to continue to receive assistance from Bretton Woods institutions; in most cases, a minimum 35 per cent grant element is required on new loans. Borrowing at non-concessional terms is allowed, but within predefined limits. Coupled with the declining interest rates used to compute the grant element of new loans, the framework severely restricts least developed countries' access to private development finance. The need for greater flexibility thus emerges in the reform proposal regarding the concessionality of loans and debt limits in IMF-supported programmes.[11]

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[9] Country capacity reflects the assessment of a country's macroeconomic and public financial management according to the joint IMF-World Bank Debt Sustainability Framework.

[10] Countries under IMF programmes have cumulative non-concessional borrowing ceilings to finance infrastructure spending. See www.imf.org/external/np/pdr/conc/index.htm for information on IMF policy.

[11] IMF, "Review of the policy on debt limits in Fund-supported programmes", 1 March 2013. Available from www.imf.org/external/np/pp/eng/2013/030113.pdf.

20. Since 2012, Rwanda, the United Republic of Tanzania and Zambia have accessed the global bond market by issuing international sovereign bonds for the first time. The ability of least developed countries to obtain access to international financial markets is facilitated by strong economic growth, high commodity prices and, above all, high global liquidity and investors' search for yield. It is crucial that least developed countries have a clear understanding of the advantages and disadvantages of international bond issues compared with other financing instruments. Eurobonds may provide a potentially important new source of funding for infrastructure projects, which often require resources that exceed aid flows and domestic savings. However, some risks remain to be considered, including foreign currency and rollover risks. Large capital inflows may also lead to undue appreciation of the exchange rate and create problems for the conduct of monetary policy. The greater risk is that "easy bond financing" may lead to increased public consumption or poor selection and execution of investment projects. More generally, market access by low-income countries raises concerns that borrowing on commercial terms, while increasing the cost of debt service, may not deliver the high growth needed to make the debt sustainable.

21. While the opportunities and risks implied by commercial loans and portfolio investments and the necessary restrictions to accessing such resources have been highly debated, non-debt-creating capital flows are generally welcomed by the international community. Indeed, over the past three decades, least developed countries experienced a dramatic surge in FDI, which now plays a lead financing role. After accounting for a negligible share of external financing in the 1980s, FDI accounted for almost three quarters of all capital inflows before the global financial crisis.[12] Since then the share of FDI has declined as a result of increased assistance by official creditors, but their value has remained high, about half of total inflows, and FDI has proved to be a particularly stable source of financing and an important factor in the resilience of least developed countries.

22. FDI flows do not create debt, but a trade-off emerges between financial soundness and the appropriation of investment returns. The insurance that FDIs provide against debt crises comes at the cost of surrendering a large share of value added to foreign firms. The problem is compounded by the use of fiscal incentives and the concentration of foreign investments into capital-intensive sectors, such as the oil/mineral industry and/or the telecommunications sector, which generate little employment. These implications should also be taken into account in the design of a policy framework for commercial loans that is not unduly restrictive and delivers an optimal financing strategy for the poorest countries in the world.

IV. Policy considerations for maintaining debt sustainability

23. The current global economic climate is characterized by slow growth and increased rate risk, and cheap sovereign financing may be coming to an end as rates on long-term bonds have begun to rise. This creates significant challenges for developed and developing countries alike in maintaining debt sustainability. This is particularly true for developing countries that have expended a significant degree of their fiscal buffers in recent years to respond to and mitigate negative shocks stemming from the global financial and economic crisis, which came on the heels of

[12] UNCTAD calculation based on IMF balance-of-payments data as at May 2013.

the food and fuel crises in 2007-2008. As a result, the policy space of developing countries has greatly diminished.

24. The uncertainties and low growth of advanced economies coupled with ample global liquidity in search of higher returns are affecting the cost-risk trade-off that developing countries face in managing their debts. The abundance of global funds is compressing yield spreads, making it easier for developing countries to access foreign capital. Low interest rates and the narrowing of bond spreads tend to favour a cost-minimizing strategy by providing developing countries with a strong incentive to fund their debts on international markets. On the other hand, the uncertainty surrounding the monetary policy stance of advanced economies, for example the timing and pace of their exit strategies, and the risks implied by their high levels of public debt could add to financial market volatility and suggest that the greatest benefits come from strategies aimed at minimizing risk.

25. Maintaining debt sustainability depends on a multitude of factors that include not only future growth but also borrowing conditions, terms of trade, foreign exchange risk and interest rate risk, among many other considerations. In the light of these challenges, reflecting on policy considerations for maintaining debt sustainability is of great importance, particularly with regard to: (a) use of borrowed funds; (b) implementation of prudent and sound debt management; (c) choice of financing sources; (d) design of an effective debt strategy; (e) engagement in responsible sovereign lending and borrowing; and (f) formulation of an international debt workout mechanism.

26. The decision as to how to use borrowed funds is important to ensuring debt sustainability. For instance, the funds raised by issuing debt should be invested in projects that have a high private or social return. When borrowing in foreign currencies, countries should take great care to ensure that their future export revenues will be sufficient to service the additional debt. Debt accumulation is likely to be unsustainable if domestic or foreign borrowing is used to finance public or private consumption with no effect on long-term growth. However, there are conditions under which even debt used to finance productive investment could turn out to be unsustainable. This happens if the ex-post returns on a project end up being lower than the interest and principal debt repayments. In fact, not only are investment returns difficult to predict, but debt service costs are uncertain. For instance, debt service costs depend on the characteristics of the debt, such as whether debt instruments are denominated in domestic or foreign currency, have a short or long maturity and pay fixed or index-linked rates.

27. Prudent and sound debt management is important to maintaining debt sustainability. Choosing the proper financing instruments is crucial to guaranteeing debt sustainability. As the sensitivity of debt service costs to the shocks hitting the economy depends on the composition and maturity of the debt, a long and balanced maturity structure can significantly reduce the risk from interest rate fluctuations. Debt denominated in local currency can avoid capital losses from exchange rate depreciations. Fiscal sustainability may also be endangered by unexpected deflation to the extent that debt service is fixed in nominal terms, while investment yields real returns. The fact that most shocks to the debt-to-GDP ratio depend on the debt composition suggests that effective debt management can be as important as fiscal policy. This contrasts with debt sustainability exercises that focus on the dynamics of the budget deficit. The fact that the reported deficits account for only a small part

of the changes in the debt-to-GDP ratio in developing countries points to the importance of balance sheet effects associated with the debt structure.

28. Large stocks of foreign reserves and the possible emergence of contingent liabilities also suggest that debt sustainability can no longer be examined with sole reference to public debt; it must also involve the assessment of all assets and liabilities of the public sector. Greater attention to the relation between assets and liabilities in the government balance sheet is beneficial because it naturally leads to the analysis of debt sustainability, as the costs of debt financing are directly linked to its benefits in terms of investment/asset returns. An asset and liability approach also puts in place a prudential framework to monitor all relevant risks to which a Government is exposed, such as commodity price risk, fiscal risk and the emergence of contingent liabilities, in addition to liquidity, currency and interest rate risk.

29. It is important for countries to carefully weigh the risks and benefits of each source of financing to ensure debt sustainability. The sources of financing that are currently available to sovereign borrowers have greatly diversified. This provides developing countries with more financing options and greater opportunities but also poses greater challenges to debt management, particularly with regard to choosing among funding instruments. Given the broader array of financing sources, developing countries now face more trade-offs in defining their optimal funding strategies, as some of them can choose between domestic and external debt, short- and long-term debt, loans and bonds and, in case their income is low, between borrowing on concessional and commercial terms.

30. A major decision that countries face is whether to fund investment projects and budget needs on domestic or foreign markets. Over the past two decades, a number of developing countries have developed and deepened domestic bond markets, which allow their Governments to issue bonds denominated in local currencies.

31. The choice between domestic and foreign markets for funding involves a trade-off between cost and risk. The advantage of issuing local currency debt is that it can serve as an effective strategy for developing countries to reduce their vulnerability to exchange rate valuation effects caused by excessive capital inflows followed by sudden stops and capital reversals. Debt denominated in local currency also increases the policy space because it allows the monetary authority to counter external shocks, such as commodity price shocks or slowdowns in world demand, through exchange rate depreciations without bringing about a sudden jump in the debt-to-GDP ratio and, possibly, a debt crisis. In fact, while currency depreciation is the least painful way to restore external sustainability, this option is precluded or is very costly in the presence of a large share of foreign currency debt. However, the insurance provided by domestic debt does have its drawbacks, as it is costly to obtain, as shown by the higher interest rates that developing countries pay on domestic bonds relative to those issued in global markets. Furthermore, domestic debt increases the exposure to refinancing risk owing to its short maturity and is vulnerable to capital flights, especially when it is held by foreign investors.

32. As debt sustainability depends on both the costs and the risks of debt service, defining an effective debt strategy is a difficult task. For example, an effective strategy must choose the composition between domestic and foreign debt that strikes the optimal balance between cost and risk. Countries will have to assess whether the higher interest rate on domestic debt represents a fair compensation for insurance or a premium for the illiquidity of the domestic market or the exchange rate

depreciation that could occur, and whether such expectation is justified or reflects the lack of credibility of the monetary/exchange rate policy. Even more difficult is comparing the expected cost differential of the debt strategies with the risk that they imply, since there is no easy way to quantify such risks and estimate their potential implications for debt sustainability. In fact, debt sustainability analysis tries to evaluate the effects of such risks by "stress testing" the accumulation of debt under alternative scenarios. Unfortunately, the results of such exercises ultimately rely on the probability of the occurrence of different shocks and their relative dimension. This determination remains a matter of personal judgement or, if estimated from past data, is based on faith that the past will repeat itself. The problem that must be solved is compounded by other dimensions of the debt strategy, which range from the choice of the maturity structure to the indexation of interest payments.

33. The complexity of maintaining debt sustainability has certainly increased together with the sources of financing and the types of instruments that countries may choose to avail themselves of. However, debt management has gained an increasingly important role in minimizing vulnerabilities to ensure debt sustainability and prevent crises. Risk minimization has gained increasing support as the main objective of debt management, which has led many countries to develop domestic debt markets, broaden the investor base and issue fixed-rate long-term bonds denominated in domestic currency, which provide budget insurance against both supply and external shocks. This greater attention to the insurance role of debt management and the recognition of the importance of sovereign debt structure for crisis prevention are the results of lessons learned from past crisis. Greater debt management capacity has allowed developing countries to withstand the global crisis and maintain relatively high growth.

34. The co-responsibility of sovereign lenders and borrowers should be promoted. In this respect, UNCTAD coordinated a high-level expert group with the participation of various stakeholders and formulated the principles on responsible sovereign lending and borrowing in 2012. These principles clearly specify the responsibility of both sovereign borrowers and lenders to sovereigns by advocating for the use of a good code of conduct and institutional set-up in concluding debt transactions. It would be a big step forward for debt crisis prevention if lenders and borrowers could uphold high standards on such aspects as due diligence, transparency and proper approval, among others, instead of succumbing to the temptations of seeking the highest returns and overborrowing. In the same vein, the Human Right Council and civil society have also encouraged stakeholders to embrace the notion of co-responsibility by formulating principles and guidelines.

35. The risks to debt sustainability posed by a complex international economic situation that emerged as a result of the global financial crisis have reinvigorated the debate on the most effective ways to address debt default when it occurs and have a transparent, fair and efficient set of rules in place for dealing with such situations. The absence of a debt crisis resolution mechanism has led to "too little, too late" debt restructurings that have contributed to large economic and social losses. Currently, legal decisions to resolve defaults are made at the local level in a wide range of institutional contexts, at the expense of global coherence. The recent court rulings with respect to the debt of Argentina demonstrate that the absence of a coherent global debt default resolution framework introduces uncertainty and can be harmful to both creditors and debtors.

V. Debt relief and official development assistance

Heavily indebted poor countries initiative and progress on the multilateral debt relief initiative

36. As at mid-May 2013, since the issuance of the previous report of the Secretary-General two countries (Comoros and Guinea) had reached the completion point under the HIPC Initiative, bringing the total number of completion point countries to 35. At this stage the HIPC Initiative is deemed to be nearly completed, with only one country, Chad, remaining in the interim stage between the decision and completion points and three countries (Eritrea, Somalia and Sudan) having yet to reach the decision point. Thus far the decision point date remains uncertain for the pre-decision point countries. The four countries that have yet to complete the initiative share common challenges, which include preserving peace and stability, improving governance and delivering basic services.[13]

37. On average, for the 36 post-decision point HIPCs, improvements have been made with respect to decreasing debt-service-to-export ratios, from 14.5 per cent in 2001 to 3.1 per cent in 2011. However, the ratios of debt service to exports are expected to increase to 5.4 per cent in 2012 and are projected to remain above 4.5 per cent during the following five years. Of the 36 HIPCs that have actively engaged under the HIPC Initiative, 7 are classified as being at high risk of debt distress, 16 are classified as being at moderate risk and 13 are classified as being at low risk.[14]

38. The countries that complete the HIPC Initiative also benefit from additional debt relief under the Multilateral Debt Relief Initiative. Both initiatives are designed to reallocate reduced debt service payments towards increasing poverty-reducing expenditures. Debt relief alone is not a panacea to the development challenges confronting HIPCs; it is a necessary but insufficient solution and must be accompanied by additional assistance both in terms of development financing and capacity-building. However, despite the steady increase in poverty-reducing expenditures, from 6.3 per cent of GDP in 2001 to an estimated 9.8 per cent in 2012, many HIPCs are seriously off track to achieve most of the Millennium Development Goals by 2015. Nevertheless, progress towards the Millennium Development Goals varies across Goals and countries.

39. There have been several challenges encountered in the implementation of the HIPC Initiative, some of which have been inherent in its design. For example, non-Paris Club creditor participation remains a hindrance to the full delivery of HIPC debt relief. Non-Paris Club bilateral creditors and commercial creditors account for 26 per cent of the estimated cost of HIPC debt relief, and the low level of their participation has proved to be an obstacle: only 47 per cent of this share has been delivered to HIPCs. Furthermore, an estimated one third of these creditors have yet to deliver any relief at all. However, the participation of commercial creditors has reportedly increased in recent years, owing in part to a few large

[13] IMF, "Heavily Indebted Poor Countries (HIPC) Initiative and Multilateral Debt Relief Initiative (MDRI) — statistical update", 2 April 2013. Available from www.imf.org/external/np/pp/eng/2013/041113.pdf.

[14] IMF list of low-income countries debt sustainability analyses for Poverty Reduction and Growth Trust-eligible countries as at 4 April 2013.

operations supported by the International Development Association Debt Reduction Facility buy-back operations.[15]

40. While much-needed debt relief has been delivered to heavily indebted poor countries under the HIPC Initiative and the Multilateral Debt Relief Initiative, it is important for the international community to remain vigilant and avoid complacency. With the conclusion of the HIPC Initiative drawing near, lessons must be drawn to take stock of both the successes and the shortcomings of the Initiative. As it is not realistic to assume that additional challenges will not arise in the future, the international community should make its best effort to learn from this experience so as to better prepare for crisis response in the future.

Official development assistance

41. In 2012, net official development assistance (ODA) from Organization for Economic Cooperation and Development (OECD)/Development Assistance Committee donors amounted to $5.6 billion, equivalent to 0.29 per cent of their combined gross national income (GNI). In 1970, the General Assembly, in paragraph 43 of the International Development Strategy for the Second United Nations Development Decade, set a target of 0.7 per cent of GNI as the minimum net amount of ODA to developing countries that economically advanced countries would exert their best efforts to reach (see resolution 2626 (XXV)). Thus far the international community has consistently fallen short of that target on average, although a handful of donor countries have succeeded in meeting and even surpassing the target.

42. ODA continued to be negatively affected by the global crisis in 2012 as it contracted by 4 per cent in real terms compared with 2011. This is the second year of continued contraction of ODA, following a 2 per cent drop in 2011,[16] marking the first time since 1996-1997 when aid contracted in two successive years. The reduction in ODA is attributed to the tightening of government budgets in donor countries in response to increased fiscal pressure associated with the global financial and economic crisis.

43. While the OECD Development Assistance Committee survey on donors' forward spending plans for 2013-2016 reports that ODA is likely to rebound in 2013, aid volume is expected to stagnate over the medium term from 2014 to 2016.[17] This stagnation is likely associated with the uncertainty that continues to hang over the global economic climate. Another trend of concern is the shift in ODA allocations away from the poorest countries towards middle-income countries.

44. The survey also indicates that there will be a significant reduction in programmed aid to countries with the largest gaps in terms of Millennium Development Goals and poverty levels, amounting to nearly half a billion dollars. The countries identified as being primarily affected are those in sub-Saharan Africa, which have also been identified as underaided countries. Bilateral aid to sub-Saharan Africa fell by 7.9 per cent in real terms, while aid to Africa contracted

[15] IMF, "Debt relief under the Heavily Indebted Poor Countries (HIPC) Initiative", 2 April 2013. Available from www.imf.org/external/np/exr/facts/hipc.htm.

[16] OECD, "Aid to poor countries slips further as Governments tighten budgets", 3 April 2013. Available from www.oecd.org/dac/stats/aidtopoorcountriesslipsfurtherasgovernments tightenbudgets.htm.

[17] OECD, "Outlook on aid: survey on donors' forward spending plans", 3 April 2013. Available from www.oecd.org/dac/aid-architecture/OECD%20Outlook%20on%20Aid%202013.pdf.

by 9.9 per cent in 2012. In addition, OECD reported that ODA to least developed countries contracted by 12.8 per cent in real terms in 2012. The shift in aid allocations also indicates an increase in aid for core bilateral projects and programmes by 2 per cent in real terms and a contraction of core contributions to multilateral institutions by 7.1 per cent.

45. ODA is an important source of funds for developing countries that have had to weather the global financial and economic crisis and the negative impact it has had on trade, remittances, capital flows and exchange rate volatility. These contractions and shifts in allocations of ODA raise concerns with regard to the predictability of aid and its effectiveness for countries in the greatest need. Aid predictability is crucial to allowing developing countries to design and implement national development strategies. Unpredictable delivery of aid hinders the effective use of resources and budgetary frameworks to achieve productive outcomes.

46. As the international community begins its discussions on the post-2015 development agenda, it is important for donors to remain committed to the success and achievement of the Millennium Development Goals by 2015 and deliver on their ODA commitments. Success in achieving the Goals hinges greatly on the provision of adequate and predictable financing. The risks posed to the economic growth and poverty reduction of the poorest and most vulnerable countries as a result of the global crisis remain through aid and trade channels. It is imperative for donors to redouble their efforts to keep their ODA commitments and ensure that progress that has been made thus far is not lost and that future progress is not jeopardized.

Paris Club activities

47. Since the previous report, developing countries have continued to benefit from the HIPC and Multilateral Debt Relief Initiatives. As an increasing number of countries are reaching their completion point, there has been a corresponding drop in the frequency of Paris Club meetings. Thus, only three Paris Club meetings have been held since July 2012, and all of them dealt with the debt of HIPCs.

48. After Guinea reached the completion point under the HIPC Initiative in September 2012, Paris Club creditors met with the delegation of Guinea in October to consider the country's external debt situation. The treatment granted to Guinea was generous and is expected to be supportive of the country's efforts to alleviate poverty and stimulate economic development. Including pledges by some creditors for the cancellation of debt on a bilateral basis beyond the agreement reached at the Paris Club meeting, almost the entire stock of debt owed by Guinea to the Paris Club will be annulled.

49. In January 2013, a Paris Club meeting was held for Myanmar that marked the country's return to the international financial community. Myanmar had accumulated important arrears over the previous decade, and the Paris Club meeting focused on clearing those arrears and re-establishing sustainability for the country. As a result, almost $6 billion (in arrears and late interest payments), or half of the total arrears, were cancelled by Paris Club creditors. It is important to note that some countries have pledged either a cancellation or special treatment of all arrears, which resulted in the generous treatment.

50. The Comoros reached the completion point under the HIPC Initiative on 20 December 2012. The meeting in Paris was held in February 2013, and Comoros obtained a 100 per cent cancellation of its eligible debts from Paris Club creditors.

VI. Conclusions and policy recommendations

51. In spite of the worsening of key debt ratios since the previous report, the debt situation of developing countries as a group remains reasonably stable. However, the aggregated statistics mask important differences between regions and country groupings. Thus, a number of countries that have completed the HIPC Initiative continue to be classified at a high risk of debt distress. This is of particular concern, as it is accompanied by a decrease in ODA flows over the past two years, at a time when low-income countries need highly concessional financing to maintain debt sustainability.

52. As the international community continues its deliberations to shape the post-2015 development agenda to bring an end to poverty, it is evident that the Millennium Development Goals have played an important role in focusing the international community's efforts to pursue internationally agreed goals. The role of ODA in achieving and pursuing these targets is of crucial importance; hence, the declining trend in ODA is of considerable concern. While the economic situation continues to be fragile for a number of developed economies, the active engagement of donors in pursuing the achievement of the Millennium Development Goals and formulating the post-2015 development agenda is of utmost importance for promoting inclusive growth and development. In this regard, donor countries should honour their commitment to disburse 0.7 per cent of GNI for ODA.

53. For countries with access to international bond markets, the evolution of long-term interest rates observed since the beginning of 2013 could pose particular challenges. After years of historically low global interest rates in the aftermath of the subprime crisis, borrowing costs on long-term debt have started to rise. Should this trend continue over the next few quarters, developing countries will find themselves in a situation of costlier financing and continued sluggish global growth. In this context, particular attention should be given to the evolution of their balance-of-payments positions, as interest payments on debt might start increasing without a substantial improvement in their current accounts, since the demand outlook in most developed markets remains uncertain. It is of particular importance for policymakers to examine the risks posed by such a scenario and adopt appropriate strategies to secure debt sustainability in the medium term.

54. Debt sustainability hinges upon a country's debt management capacity at the institutional, human and technical levels, which is fundamental to effectively dealing with macroeconomic risk and maintaining a sustainable level of debt in the long run. Indeed, debt management is as important as fiscal policy in ensuring sustainability and maintaining the economy on a high-growth path. This requires that the proceeds from financing be invested in projects with robust economic and social returns while avoiding the build-up of debt vulnerabilities from currency and maturity mismatches. Prudential management of debt liabilities and corresponding investments is essential in achieving macroeconomic stability, thus complementing fiscal and monetary policy.

55. The international community should more actively consider the development of an agreed rule-based approach to sovereign debt workouts to increase predictability and the timely restructuring of debt when required, with fair burden sharing, including the provision of minimum outlays in the budget for social protection. An inclusive and pluralistic international working group to examine options for enhancing the international architecture for debt restructuring would be a good initiative to discuss, design and propose alternatives to the international community. UNCTAD is currently taking the lead in this direction with its project on a debt workout mechanism. It established a working group of prominent experts and stakeholders in this field, which, in July 2013, officially started to examine options for such a mechanism.[18]

56. Maintaining debt sustainability can be encouraged by the adoption of adequate policies and standards emphasizing the prevention of debt crises. In this respect, the implementation of the principles on responsible sovereign lending and borrowing is a step in the right direction. This implementation process has already started at the national and international levels through the work of auditors-general and will proceed with the provision of technical assistance, upon member States' request, from 2014. The endorsement of the principles by both developing and developed countries indicates their wide-ranging applicability, as well as the holistic understanding of global debt problems and their possible remedies.

57. In accordance with General Assembly resolution 67/198, the international community should continue discussions on ways to improve the functioning of the international financial system and the role that credit rating agencies play in it. In particular, further attention should be given to policies and measures that would reduce spillover and contagion effects that rating decisions can create. As an increasing number of developing countries have obtained a credit rating, the debate on the role of credit rating agencies in the global financial architecture has gained importance over time.

[18] Members and observers of the working group of the UNCTAD project currently include prominent legal and economic experts, representatives from IMF, the World Bank, the Paris Club, the private sector, non-governmental organizations, think tanks, labour unions, the African Development Bank, the Commonwealth secretariat, the Inter-Parliamentary Union, the International Organization of Supreme Audit Institutions, the Asian Development Bank, the Inter-American Development Bank and the European Bank for Reconstruction and Development.

Annex

External debt of developing countries[a]

(Billions of United States dollars)

	All developing countries and countries with economies in transition					*Sub-Saharan Africa*				
	2000-2008	*2009*	*2010*	*2011*	*2012*[b]	*2000-2008*	*2009*	*2010*	*2011*	*2012*[b]
Total debt stocks	2 618.7	3 827.4	4 322.7	4 787.3	5 379.6	222.0	247.6	270.2	294.5	313.2
Long-term debt	2 050.6	2 892.2	3 126.0	3 404.0	3 763.7	175.7	182.6	203.2	229.1	248.4
Private (share)	64.7	73.7	74.1	75.4	76.6	28.9	42.5	48.7	51.4	56.6
Private non-guaranteed (share)	35.0	46.3	47.4	48.8	50.8	9.4	17.5	21.0	22.1	20.3
Short-term debt	485.3	789.8	1042.1	1228.7	1458.8	38.5	45.0	47.4	44.6	45.5
Arrears	93.0	76.9	61.9	59.8	60.1	39.4	31.5	28.9	27.0	27.1
Debt service	363.6	489.6	510.4	554.6	609.2	14.3	13.0	13.1	15.2	16.6
International reserves	1 929.7	4 777.5	5 476.6	5 996.9	6 267.5	78.1	158.0	159.7	176.8	200.1
Debt indicators (percentage)										
Debt service/exports[c]	12.0	10.6	8.8	7.9	8.5	6.7	4.3	3.4	3.2	3.5
Total debt/exports	85.9	83.1	74.4	68.3	75.2	101.9	80.6	68.7	62.3	66.1
Debt service/GDP	3.9	3.0	2.6	2.4	2.5	2.5	1.4	1.2	1.2	1.3
Total debt/GDP	27.9	23.3	21.8	20.7	22.0	37.9	26.5	24.0	23.5	24.3
Reserves/short-term debt	401.8	609.3	528.1	489.5	430.7	208.4	359.6	346.6	408.8	451.2
Reserves/M2	27.5	30.3	29.1	27.1	24.8	32.5	35.1	30.5	30.4	33.6

	Middle East and North Africa					*Latin America and the Caribbean*				
	2000-2008	*2009*	*2010*	*2011*	*2012*[b]	*2000-2008*	*2009*	*2010*	*2011*	*2012*[b]
Total debt stocks	152.0	159.9	166.1	166.1	171.1	794.9	946.9	1086.8	1233.5	1392.1
Long-term debt	123.6	118.8	120.5	119.8	123.4	656.9	782.7	883.6	1032.4	1168.8
Private (share)	32.0	34.2	35.3	34.6	35.6	79.3	80.9	80.6	83.1	81.3
Private non-guaranteed (share)	4.7	5.3	5.5	6.1	6.0	35.2	41.5	43.1	47.9	49.8
Short-term debt	26.1	32.8	37.2	38.2	39.3	115.4	139.5	177.9	175.6	200.7
Arrears	7.6	0.7	0.8	0.8	0.0	22.2	32.2	16.4	21.4	22.5
Debt service	19.0	17.6	16.4	18.2	18.4	137.0	139.7	136.4	162.3	170.1
International reserves	173.2	362.9	374.6	370.3	354.9	261.0	536.5	620.1	725.0	784.8
Debt indicators (percentage)										
Debt service/exports[c]	9.2	5.9	4.7	4.9	5.9	21.7	17.0	13.3	13.0	13.3
Total debt/exports	73.8	53.2	47.3	45.1	54.5	125.7	115.0	106.2	98.6	109.1
Debt service/GDP	3.4	1.8	1.5	1.5	1.4	5.2	3.5	2.7	2.9	3.1
Total debt/GDP	27.2	16.6	15.2	13.6	13.1	30.2	23.7	21.9	22.1	25.0
Reserves/short-term debt	664.9	1108.0	1006.2	970.4	903.7	226.1	384.5	348.4	412.7	391.0
Reserves/M2	48.6	58.4	62.7	58.8	53.8	22.4	24.4	22.9	23.1	22.4

	East Asia and the Pacific					South Asia				
	2000-2008	2009	2010	2011	2012[b]	2000-2008	2009	2010	2011	2012[b]
Total debt stocks	601.2	871.0	1 066.9	1 240.1	1 473.4	211.5	360.6	401.5	451.5	499.4
Long-term debt	420.1	521.6	569.1	597.2	701.6	188.8	290.1	317.7	345.4	374.6
Private (share)	58.2	61.4	63.4	64.4	66.8	40.0	50.5	51.5	53.3	56.6
Private non-guaranteed (share)	36.3	41.0	43.8	44.9	46.1	29.6	42.3	41.2	42.3	45.1
Short-term debt	171.6	328.8	477.7	622.8	747.1	18.7	52.1	63.8	86.2	103.5
Arrears	12.6	5.6	6.2	6.4	6.5	0.1	0.1	0.1	0.2	0.0
Debt service	79.3	96.7	105.6	114.5	139.9	25.0	21.6	30.2	33.7	39.9
International reserves	972.6	2 778.1	3 313.1	3 706.1	3 861.3	147.8	293.6	309.4	302.8	301.5
Debt indicators (percentage)										
Debt service/exports[c]	6.4	4.8	4.0	3.7	4.3	13.3	6.6	7.1	6.4	7.7
Total debt/exports	48.2	43.2	40.9	39.9	45.5	112.9	110.3	94.3	85.9	95.7
Debt service/GDP	2.6	1.5	1.4	1.2	1.4	2.5	1.3	1.5	1.5	1.7
Total debt/GDP	19.6	13.8	14.1	13.4	14.4	21.5	21.7	19.6	19.7	21.6
Reserves/short-term debt	570.0	848.1	695.6	596.6	518.1	793.1	564.0	485.2	351.5	291.6
Reserves/M2	23.7	27.8	27.6	25.4	22.7	24.6	24.3	21.0	20.9	18.8

	Europe and Central Asia				
	2000-2008	2009	2010	2011	2012[b]
Total debt stocks	636.9	1 241.5	1 331.3	1 401.6	1 530.4
Long-term debt	485.4	996.3	1 031.9	1 080.2	1 146.9
Private (share)	81.3	91.6	90.8	90.8	93.0
Private non-guaranteed (share)	52.9	64.1	65.0	64.4	67.9
Short-term debt	115.1	191.6	238.0	261.3	322.8
Arrears	11.0	6.8	9.5	4.0	4.1
Debt service	88.9	201.0	208.9	210.7	224.3
International reserves	297.0	648.3	699.8	715.9	765.0
Debt indicators (percentage)					
Debt service/exports[c]	16.3	24.8	21.3	16.7	17.1
Total debt/exports	115.2	152.6	135.1	111.1	116.8
Debt service/GDP	5.7	7.8	6.8	5.8	5.9
Total debt/GDP	41.2	49.3	44.2	39.3	41.1
Reserves/short-term debt	263.3	342.6	295.9	273.8	237.0
Reserves/M2	55.7	52.5	46.5	41.5	40.8

Source: United Nations Conference on Trade and Development calculations based on the World Bank International Debt Statistics 2013 online database.

[a] As defined in the International Debt Statistics 2013 online database.

[b] Figures are estimates.

[c] Exports comprise exports of goods, services and primary income.